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MEMORANDUM FOR: ADDI

We suggest that the attached be issued as an Intelligence Brief to key officials in State, Treasury, DOD, and the NSC Staff who follow developments in the Middle East.

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16 Jan 75
(DATE)

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MEMORANDUM

Economic Viability of a Palestinian StateSummary

An autonomous Palestinian state consisting of the West Bank and Gaza Strip would be unable to maintain current living standards without subsidies of from \$50 to \$100 million annually from Arab States and continued close economic links with Israel. Given these conditions, economic development would quicken but the area lacks the basic human and natural resources to become economically self-sufficient as an independent state for a considerable period of time.

Real per capita income in the West Bank and Gaza has more than doubled since 1967 largely because of economic ties with Israel. Most significant are the 70,000 Palestinians employed in the labor-short Israeli economy, the stimulus provided minor manufacturing by subcontracting work for Israeli firms, and the Israeli market for surplus agricultural products.

A Palestinian state with access to Arab money could initiate work on infrastructure projects and finance the expansion of governmental and educational services. But without an Israeli market for labor and goods, a new Palestinian state would face a long period of being on the Arab dole.

The Economic Setting

The Jordanian West Bank and Egyptian Gaza Strip together contain about 10% of the land area occupied by Israel in the 1967 war and more than a million Palestinians, about 90% of the population of the territories (see the Table below). On the West Bank,

before the war, agriculture contributed nearly 40% of gross national product (GNP) and employed 60% of the labor force. Except for grain, the West Bank was generally self-sufficient in food production. Industry consisted almost entirely of handicrafts and small plants processing simple consumer goods.

The Gaza Strip, under Egyptian military administration, had little agriculture or industry to sustain it economically. Most of the residents were refugees and they were heavily dependent on the United Nations Relief and Works Agency (UNRWA) and the Egyptian government for their livelihood.

Selected Economic Statistics

	<u>West Bank</u>	<u>Gaza Strip</u>
Land area (square miles)	2,100	400
Population	657,000	390,000
Of which refugees	290,000	320,000
Estimated per capita GNP (1973)	\$350	\$250
1973 trade (million US \$)		
Exports to Israel	41	25
Exports to rest of world	19	19
Imports from Israel	115	76
Imports from rest of world	18	7

The "Miracle" Under Israeli Administration

The stimulus to industrial development in the territories since 1967 has come from access to the buoyant Israeli economy and particularly from Israeli subcontracting to Arab firms. In addition, skills have been picked up by the 70,000 residents of the West Bank and Gaza -- about one-third of the total work force of each territory -- who are employed in Israel.

During the seven years under Israeli control, more than 50 new plants have been established on the West Bank and about 150 small workshops set up in Gaza. They produce a narrow range of consumer goods and simple manufactures. About 8% of the total labor force of Gaza and the West Bank is employed in industry. Despite a shortage of arable land and water, crops responsive to local demands have been developed and citrus crops for export have been pushed. West Bank agriculture produced crops valued at \$95 million in the 1972/73 crop year with citrus and other fruit and vegetable crops accounting for over 50%. Agricultural production in the Gaza Strip was valued at \$46 million in the 1972/73 crop year with fruits and vegetables representing three-quarters of the total.

Agricultural and industrial products not consumed locally are for the most part exported to Israel, with much of the citrus re-exported to Western Europe. Such sales, earnings from employment in Israel, and assistance from Israel and UNRWA offset the large trade deficits of the territories (see the Table below). Other than grain from the US and Western Europe, most import needs (fuel, cement, fertilizers, raw cotton, pharmaceuticals, machinery and equipment, transport vehicles, and finished consumer goods) come from Israel.

Basic Balance of Payments, 1973

	<u>Million US \$</u>	
	<u>West Bank</u>	<u>Gaza Strip</u>
Merchandise trade	- 74	-39
Exports	60	44
Imports	-134	-83
Services	- 35	-15
Wages	86	52
Transfers	35	31
Apparent surplus	12	29

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Israeli and Arab Policies

Israel has maintained a low profile in the West Bank and the Gaza Strip by using local resources, labor, and organizations. Only 500 of the 13,000 persons providing administrative services in the West Bank and Gaza Strip in recent years are Israeli.

Excluding direct military expenditures, Israel's annual civil administration bill has been running slightly more than \$10 million in the West Bank and \$15 million in the Gaza Strip.

The Jordanian government and other Arab states have done nothing to stimulate economic intercourse with the West Bank and Gaza Strip since the Israeli occupation. Trade has remained small. Imports from Jordan, for example, totaled only \$4 million in 1973 and following the recent Rabat conference Jordan stopped its minor subsidization of civil service salaries on the West Bank.

Economic Potential of an Independent State

With water supplies scarce, large amounts of land unsuitable for cultivation, and raw materials for industry lacking, economic self-sufficiency would be difficult to achieve. As an independent state, development would be contingent on:

- Strict controls on the influx of Palestinian refugees from neighboring states which number some 1.2 million.
- Arab financial support for government operations and economic development on the order of \$50 to \$100 million a year.

Development at the outset would have to be directed to infrastructure projects -- irrigation, electric power, roads -- because of the limited economic base for the expansion of industry.

Agriculture also offers only limited prospects for development. Projects could be tailored, however, to increase output of cash crops, such as vegetables, melons.

fruit, and olives, for export to its food-deficit Middle Eastern neighbors. Expanded extension services and educational programs begun by Israel would be needed to improve yields while low-cost credit programs would have to be implemented to encourage more widespread use of farm machinery, fertilizer, and other inputs. Improvements of roads and storage facilities would be required to facilitate the movement of goods from farm to market.

The West Bank and Gaza Strip have few natural resources to support industrial development. Raw materials consist mainly of rock, sand, and salt. The labor force is trainable and, for the time being, still low-cost compared with Israel and Western Europe. Management skills, however, are in short supply. Small-scale industry and handicrafts could be expanded to rising local demands, but the development of export industries, such as food processing and textiles, would require not only capital and technology but also the development of management and marketing skills. The establishment of assembly-type industries would encounter many of the same problems. Like Israel, industry in a Palestinian state would be dependent on imported raw materials or semifinished goods -- a dependence which would increase apace with industrialization.

With its concentrated population, the Gaza Strip has a long-term potential for labor-intensive light industry, oriented for West European and Israeli markets. Development and upgrading of port facilities in Gaza could lead to the establishment of a duty-free manufacturing zone.

The service sector offers the greatest potential in the short run. The expansion of local administrative and planning bodies and the development of banking and credit institutions would facilitate investment and economic development and provide an important source of employment. Local Arab administrators now provide only day-to-day basic services, such as sanitation, road maintenance, and in some instances electric utilities. The establishment of a West Bank university and the expansion of other educational facilities would provide the basis for developing the vocational and professional skills needed to upgrade the labor force.

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